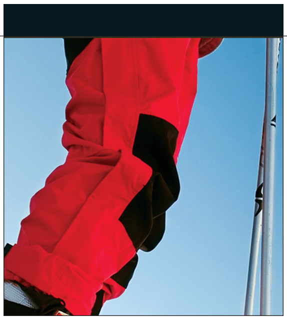

Color In the Details for Clients Getting a "Gray Divorce"

Having had more years to acquire assets, and with less time to amass future wealth, those divorcing later in life have particular planning concerns.

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The divorce rate for Americans over the age of 50 reportedly doubled between 1990 and 2010, and the divorce rate for those over 65 has more than doubled. One in four divorces are couples over the age of 50, while one in ten divorces are couples aged 65 and older.[1] This trend has prompted the catch phrase: "gray divorce."

The rise in "gray divorces" can be attributed to the elimination of what was once the social stigma of divorce, increased life expectancies, the changing socioeconomic status of women, and increased opportunities to find a new and potentially more satisfying partner. While the consequences of this "gray" revolution are largely unknown, some conclusions can be made. Gray divorces often present financial security issues because couples who divorce later in life have fewer remaining working years to recoup the financial losses occasioned by divorce.

In addition, gray divorces are more likely to involve the issues discussed below, and they should be carefully considered.

Division of assets

The division of assets is integral to all divorces. For older adults, who are more likely to have an assortment of assets from varied sources, however, divorce brings the realization that their carefully nurtured nest egg is about to be undone.

For instance, in Maryland (the state in which the authors practice), the first step in the distribution or adjustment of assets is determining which property is marital and which is non-marital. Marital property is defined by Maryland Family Law Article § 8-201(e) as any property, however titled, acquired by either or both of the parties during the marriage. Marital property, however, does not include property acquired before the marriage, any property acquired by inheritance or gift from a third party, property excluded by valid agreement, or property "directly traceable" to any of these sources.[2]

The term "acquired" within the meaning of Maryland Family Law Article § 8-201(e) does not refer to the time at which title or possession of the property is obtained. Rather, the term refers to the ongoing process of making payments toward the purchase of that property, so the characterization of property as non-marital or marital depends upon the source of each contribution as payments are made.[3]

Where a particular asset is partly marital and partly non-marital, the portion of property directly traceable to a non-marital source is not subject to distribution upon divorce. Maryland's "Source of Funds The-

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ory" provides that a spouse who contributed non-marital funds toward acquiring property is entitled to an interest in that property equal to the ratio of the non-marital investment to the property's total value.[4] The remainder of that property acquired with funds earned during the marriage is characterized as marital property, and its value is subject to equitable distribution.

This rule, however, has a key exception. The "Source of Funds Theory" does not apply to any real estate held by the couple as tenants by the entireties.[5] All real property owned as tenants by the entireties is marital property.[6] Still, Maryland law requires "equitable" not "equal" division of property once it is determined to be marital in nature.[7] It is, therefore, arguable that a party contributing substantial non-marital funds to acquire the property should receive a greater share, as in the case of *Richards v. Richards*,[8] where the Court of Special Appeals affirmed an equitable adjustment reflecting the contribution of one spouse's inherited funds into a commingled account.

Inherited, gifted, and commingled assets

Couples in their 50s and 60s are more likely to have inherited property from their parents or other relatives and are therefore, more likely to have non-marital property. Maryland law affords a spouse who owns non-marital property the ability to preserve its non-marital nature even if it is changed in character or form during the marriage.

But in order to preserve the non-marital nature of the property, that spouse is cautioned to keep the property sequestered in his or her own name, or less secure, be able to trace the asset acquired during marriage directly to a non-marital source. In the seminal case of *Melrod v. Melrod*,[9] the Court of Special Appeals held that if a spouse chooses to commingle marital and non-marital funds to the point that direct tracing is impossible, that property may lose its non-marital status. The court found that since Mr. Melrod commingled his income from non-marital sources with his marital income, those pooled funds subsequently used to acquire property could no longer be directly traced to any source. This meant that any property acquired with those commingled funds was marital property.

Even if a home in one spouse's name was purchased during the marriage with inherited funds, the property can still be rendered partially marital property. This occurred in a case where major improvements were made to the home using marital income or funds.[10]

Home-sale income tax exclusion

In a gray divorce, one of the largest components is the marital home, which has often been paid-off and substantially appreciated in value. If one spouse wants the house, that spouse will have to find enough money to buy the other's interest.

If the home is sold to a third party, both spouses should make sure that tax issues are reviewed prior to an agreement or court trial so that neither spouse ends up with a tax bill that could have been reduced or avoided. The Internal Revenue Code provides an exclusion from income for gain from the sale or exchange of a principle residence of up to $250,000 for individuals filing as singles and $500,000 for joint filers.[11]

In order to be eligible for this exclusion of income from tax, three requirements must be satisfied under Section 121(b)(2)(A):

1. Either spouse meets the ownership requirement.
2. Both spouses meet the "use" requirement.
3. There has been no sale or exchange of a principle residence to which the exclusion was applied by either spouse within the past two years during the five-year period preceding the year of the property sale.

If the sale of the home occurs before the divorce is final, the sale could be reported on a joint return and the couple can exclude up to $500,000 of gain. If instead the sale occurs after the divorce, each spouse could exclude up to $250,000 on their separate returns.

When a spouse moves out of the home and cannot meet the "use" requirement under Section 121, as is often the case, the parties should make sure their agreement or divorce decree allows them to take advantage of a special exception that exists for separated or divorced taxpayers. The exception in Section 121(d)(3) treats the non-occupant spouse as "using" the home as his or her principal resi-

1 Brown, Lin, and Payne, "Age Variation in the Divorce Rate, 1990-2012," National Center for Family & Marriage Research (2014), available at www.bgsu.edu/content/dam/ BGSU/ college-ofarts-and-sciences/ NCFMR/ documents/ FP/FP-14-16-agevariation-divorce.pdf (last visited 7/19/2016). See also Franklin, "Gray Divorce Boosts Poverty Level for Women," Investment News, 1/12/2016, available at www.investmentnews.com/article/20160112/BLOG05/160119983/gray-divorce-boosts-poverty-level-for-women (last visited on 8/3/2016).

2 See Maryland Family Law Article § 8-201(e)(3).

3 See e.g., Harper v. Harper, 294 Md. 54, 448 A.2d 916 (1982); Grant v. Zich, 300 Md. 256, 477 A.2d. 1163 (1984) (superseded by statute as stated in Gordon v. Gordon, 174 Md. App. 583, 923 A.2d 149 (2007).

4 *Id.*

5 See Gordon v. Gordon, *supra* note 3 (citing Fader and Gilbert, *Maryland Family Law,* § 15-7(f), at 15-34 (4th ed., 2006)).

6 *Id.*; Maryland Family Law Article § 8-201(e)(2).

7 Richards v. Richards, 166 Md. App. 263, 888 A.2d 364 (2005).

8 *Id.*

9 83 Md. App. 180, 574 A.2d 1 (1990).

10 Merriken v. Merriken, 87 Md. App. 522, 590 A.2d 566 (1991).

11 IRC Section 121.

dence during any period of ownership while the occupant spouse is granted use of the property. In effect, the exception allows the couple to fulfill the use requirement while only one spouse is living in the home. To ensure eligibility for this exception, both spouses must remain on the title of the home and one spouse must continue to use it as a personal residence.[12]

Alimony

Despite the recent strides made by women toward wage equality and socioeconomic gains, the economic disparity between men and women widens with age. Although more than 50% of women between the ages of 55 to 64 are employed, women still earn less than men. Combined with the fact that women also tend to live longer than men, women face a greater financial risk compared to men.

Moreover, studies show that gray divorces have had a disproportionate financial effect on women: 27% of gray divorced women live below the poverty line compared to just 11% of gray divorced men.[13] In addition, on average, gray divorced women receive less Social Security benefits than gray divorced men and other single women.[14]

The possibility of receiving or paying spousal support/alimony needs to be carefully assessed. In Maryland, temporary alimony, which is intended to provide financial support just long enough for the lower earning spouse to get back on his or her feet, is more common among younger couples. By contrast, the role of spousal support/alimony for those exiting long-term marriages, especially late in life, could be much different.

Ultimately, multiple statutory factors influence an alimony award, including the length of the marriage, the health of both parties, the ability of the party seeking alimony to be wholly or partly self-supporting, the contributions (both monetary and nonmonetary) of each party to the well-being of the family, etc.[15]

One way spouses can protect themselves financially is to ensure the spouse with a pension has elected survivor's benefits that will extend to the former partner.

Retirement savings

Spouses in a gray divorce have fewer working years left to contribute to retirement accounts. Early withdrawals from retirement funds can result in penalties and fees, so one or both spouses may have to delay retirement and ultimately adjust their standards of living. One way spouses can protect themselves financially is to ensure the spouse with a pension has elected survivor's benefits that will extend to the former partner. If the election is not made, the retirement benefits cease when the participant spouse passes away.

Again, both spouses will want to make sure that tax issues are reviewed prior to finalizing a separation agreement so that neither spouse ends up with a tax bill that could have been reduced or avoided. To split retirement assets, a divorcing couple needs a qualified domestic relations order (QDRO) designed to accomplish the division of these assets and to ensure a tax-free transfer.

Estate planning

It is also common to have acquired, during the marriage, insurance policies, signed a will or power of attorney that benefits the other spouse, or named the other spouse as an executor. Individuals going through a gray divorce should discuss these issues with divorce counsel to determine if changes should be made sooner rather than later. Individuals may not want their soon-to-be-ex-spouse as the beneficiary of their estate or have powers under a health care directive or general power of attorney.

Without sound legal advice and careful financial planning, late-life divorcées risk becoming economically disadvantaged in comparison to their single or married counterparts. When contemplating divorce, these individuals should perform a thorough and honest assessment of their projected post-divorce income and expenses. They may wish to consider, as part of any settlement discussions, issues relating to their adult children, including financial support for higher education, weddings, or grandchildren.

Conclusion

In the wake of gray divorces, it is more important than ever for divorce attorneys to team up with estate planners, financial advisors, accountants, elder law attorneys, and other professionals to ensure that their clients' financial futures are as secure as possible. While picking up and starting over can be emotionally and financially challenging, seeking the advice of an experienced divorce lawyer will help to ensure that the next chapter of the client's life gets off on the right foot. ■

12 Stolz, "Broken Home: Divorce and the Principal Residence," J. Accountancy (9/1/2009), available at www.journalofaccountancy.com/issues/2009/sep/20091764.html (last visited on 8/3/2016).

13 Franklin, *supra* note 1.

14 Ellin, "After Full Lives Together, More Older Couples Are Divorcing," NY Times, 10/30/2015, available at www.nytimes.com/2015/10/31/your-money/after-full-lives-together-more-older-couples-are-divorcing.html?_r=0 (last visited on 8/3/2016).

15 See Maryland Family Law Article § 11-106.